MPAC Group plc

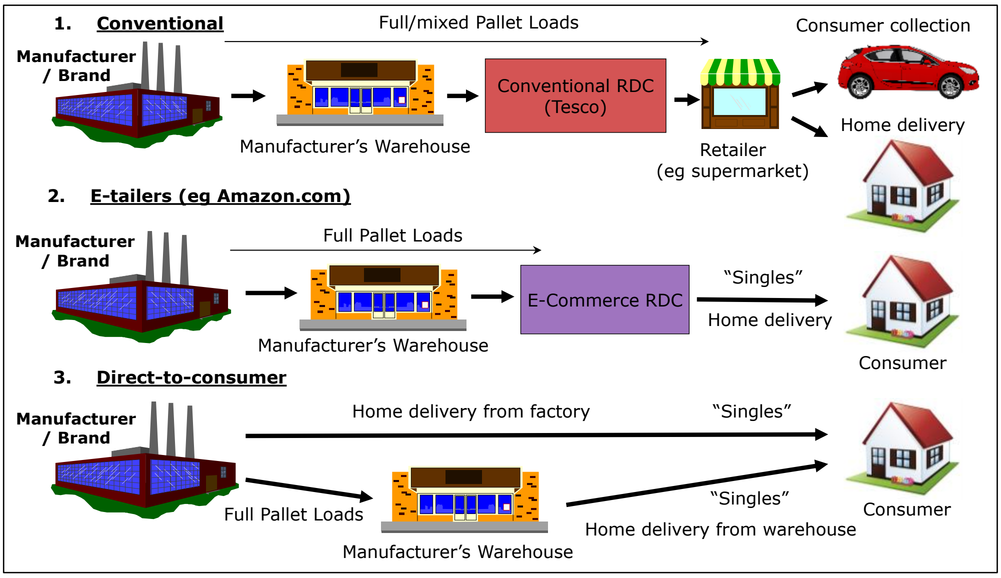
5th March 2019

Gearing up for double digit growth

Amid all the concerns about Brexit, the slowing Eurozone/Chinese economies and trade tariffs, the long-term fundamentals of aging populations, environmental/nutritional awareness and ecommerce remain intact. Not least within the healthcare and FMCG space, where brand owners (eg Unilever, Diageo & Nestle) are increasingly automating their factories with reliable, fast and computer controlled equipment.

Not only to improve efficiency, lower downtime/changeover periods and reduce wastage/cost, but also ramp up their online operations, so that they can deliver products 'direct-to-[the]-consumer' in micro-batch sizes of one (ie 'Singles'). Either straight off the production line, or via their own warehouses (see below) in an effort to neutralise the power of retailing giants such as Amazon, Walmart and Tesco.

Rising interest in "Direct-to-consumer" e-fulfilment



Source: Equity Development

Packaging machines becoming 'smarter'

The only problem is that this takes a totally new skill-set. One that requires a major reconfiguration of their manufacturing plants and distribution systems. Indeed, to put this into context Amazon Prime customers expect goods to be shipped to their door within 24 hours of ordering. Thus elevating the bar for brand owners who wish to compete, and necessitating help from outside experts.

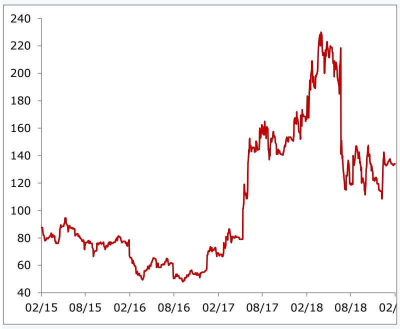
Sweet music to the likes of MPAC, a specialist provider of high-speed packaging machines and complementary services. **Its products tick all the right boxes**, and are **on track to become even 'smarter' with the inclusion of more 'Industry 4.0' functionality** - eg remote diagnostics, software, Big Data analytics & Artificial Intelligence.

Clearly this won't happen over-night, albeit good progress is already being achieved. In fact, at this morning's prelims came news that **its latest machines recently received glowing reviews at the sector's largest annual exhibition in Chicago**.

Company Data

EPIC	**AIM:MPAC**
Price (last close)	135p
52 week Hi/Lo	230p/109p
Market cap	£27.2m
Net cash (Dec'18)	£27.0m
Share count (incl Treasury)	20.172m
ED valuation/ share	200p
Avg. daily volume	25,000

Share Price, p



Source: Web Financial

Description

MPAC is a specialist provider of high speed packaging machines (79% of sales) and complementary services (21%, eg spares/maintenance) with c. 350 staff. The group (80% non UK), encompasses the design/manufacture of cartoning equipment, case packers, end-of-line and robotic solutions, as well as undertaking turnkey projects involving the design/integration of packaging systems. Here it has sites in Canada and the Netherlands, plus service engineers based throughout the world.

In Coventry (UK), the firm develops innovative technology and associated production/packaging machinery. Core verticals are Pharmaceutical (10% sales), Healthcare (35%) and Food/Beverage (55%), supporting the likes of Nestlé, GSK, AstraZeneca, Unilever, Kellogg's, Diageo, Ferrero, Hollister and CooperVision.

Next news: April 2019 AGM

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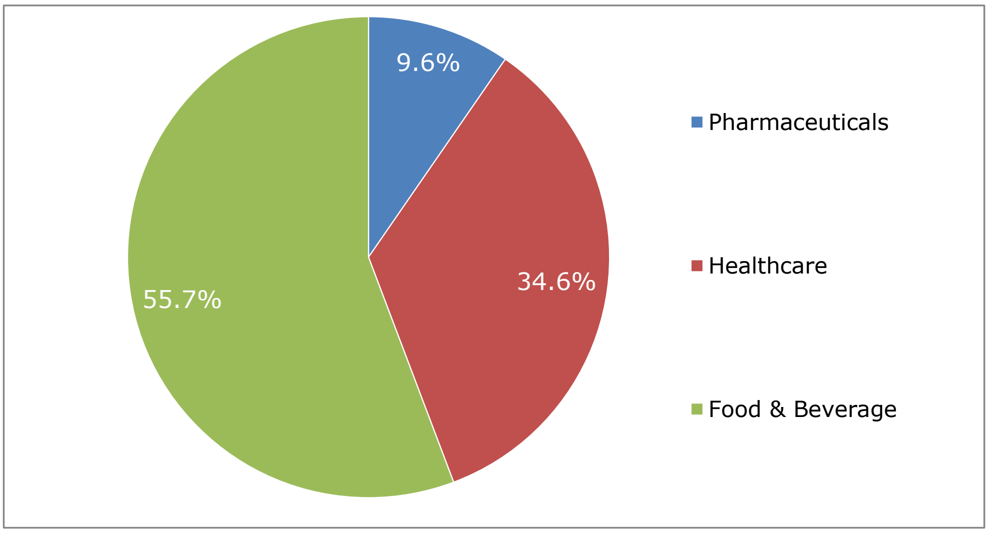
Top line climbs 9% organically

So much so, that bookings soared in H2 after a 'challenging' H1, driving **better than expected 2018 results**, and pushing the **Dec'18 closing orderbook up 16% to a record £39.8m**. Likewise **turnover leapt 9% LFL** (negligible impact from forex) **to £58.3m** (vs £53.4m LY) thanks to impressive performances (see below) from the US (+23% to £22.7m), UK (+59%, £11.6m) and Healthcare (+55%, £20.2m). Partially offset by "sluggish" demand in China and subdued order intake in EMEA for bespoke/customised solutions.

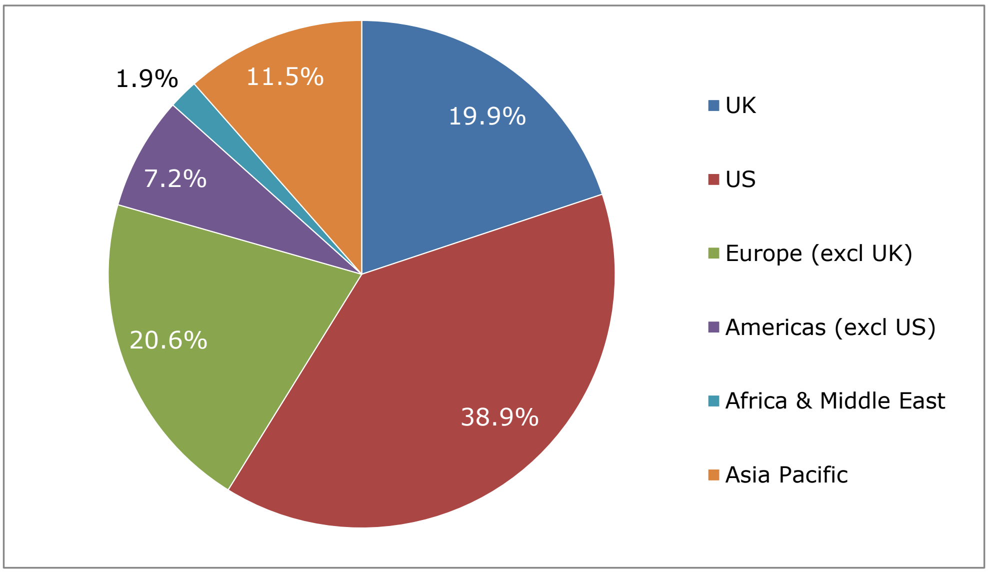
2018 revenue (£58.3m) break-down by target market



Source: Equity Development

Divisionally, **Original Equipment climbed +14% to £46.2m**, whilst Service fell 7% to £12.1m, largely because of resource being reallocated to customer installations. Encouragingly, all Service management positions have now been filled and the number of field engineers lifted, with trading back to normal by the end of 2018.

2018 regional sales (£58.3m) split

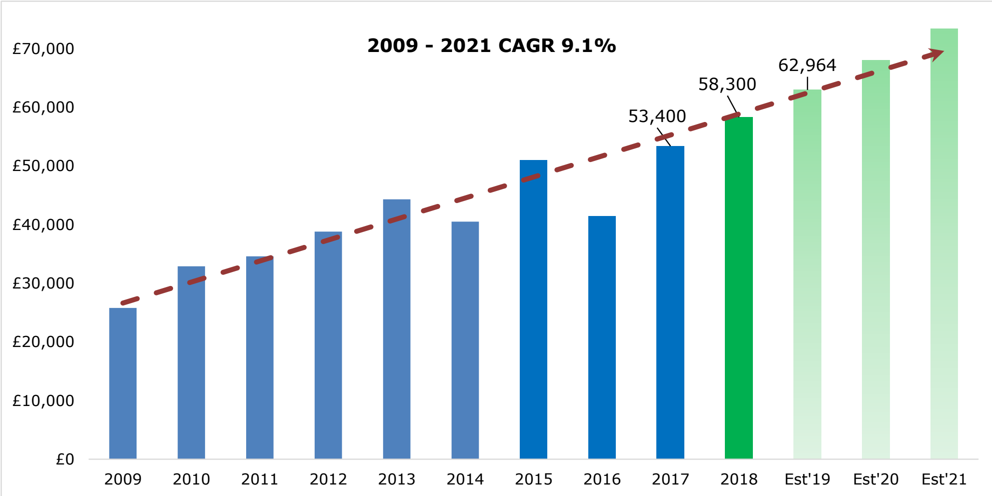


Source: Equity Development

More than 80% revenue cover for 2019

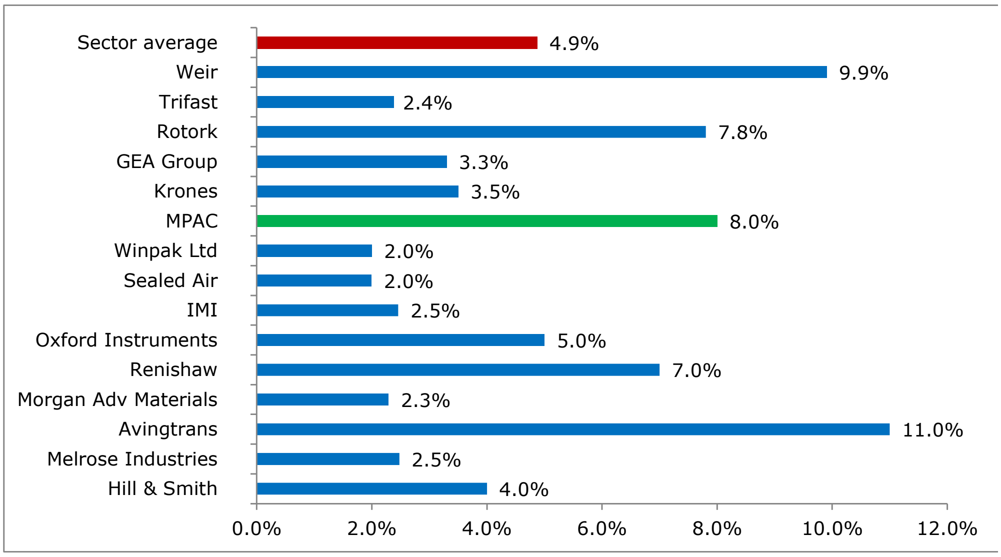
Equally, **visibility is excellent**. Here, based on the natural flow-through of the backlog, augmented by repeat Service business (eg spares), we estimate **our upgraded 2019 £63.0m sales target** (+8% YoY – see below) is already **>80% covered**. As always though, investors need to be aware that there can be some lumpiness over period ends.

Historical and future revenue progression (£'000s)



Source: Equity Development

CY +1 sales growth rate vs packaging/engineering peers



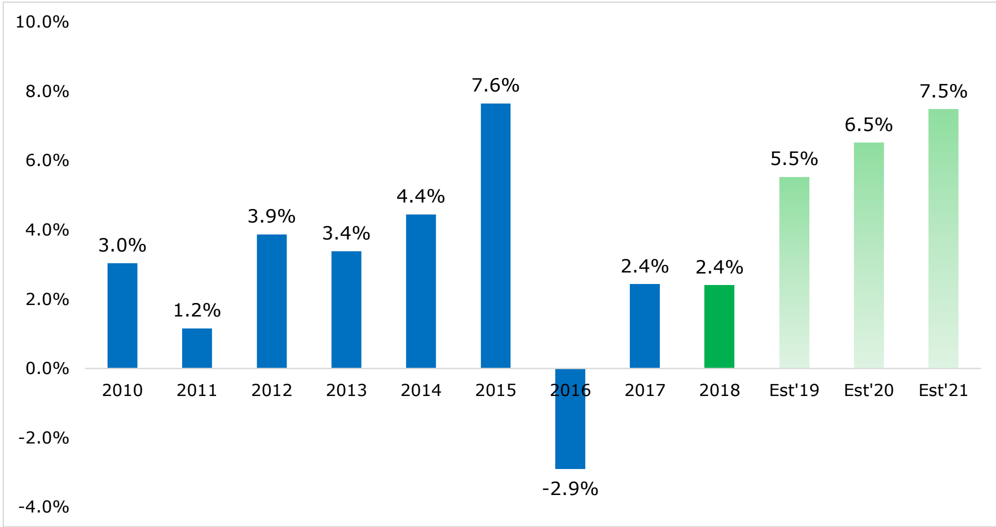
Source: Equity Development : CY = Current Year, arithmetic average for sector

Improving profit margins

Elsewhere, 2018 operating profits came in at £1.4m (£1.3m) – equivalent to a 2.4% margin – despite incurring £1.1m of one-off costs to resolve 2 legacy contracts (previously flagged) and £0.6m on the PPF statutory levy.

Underlying cashflows were strong at £4.1m (ie excluding £3.0m of pension recovery payments) bolstered by a **+£1.9m working capital swing** - leaving **year end net cash at £27m** (worth 134p/share), up from £24.9m in June '18.

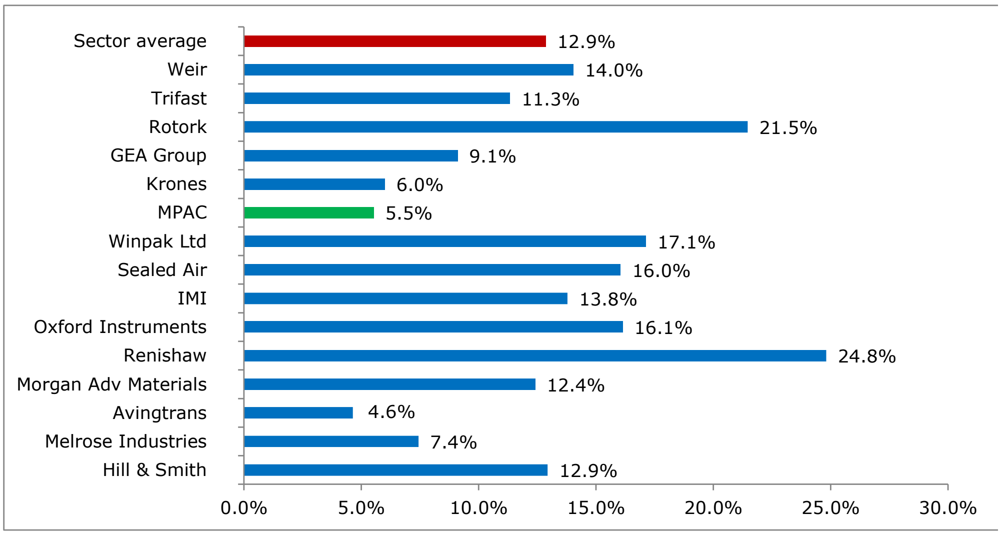
Higher and more predictable EBIT margins anticipated



Source: Equity Development

What's more, if one reverses out the £1.1m contract charge, and adds another c. £0.8m to the bottom line - reflecting the implementation of restructuring measures post June (£0.8m expense) - then **we believe EBIT margins should widen in 2019 to 5.5%** (see below).

CY EBIT margins vs packaging/engineering peers



Source: Equity Development, arithmetic average for sector

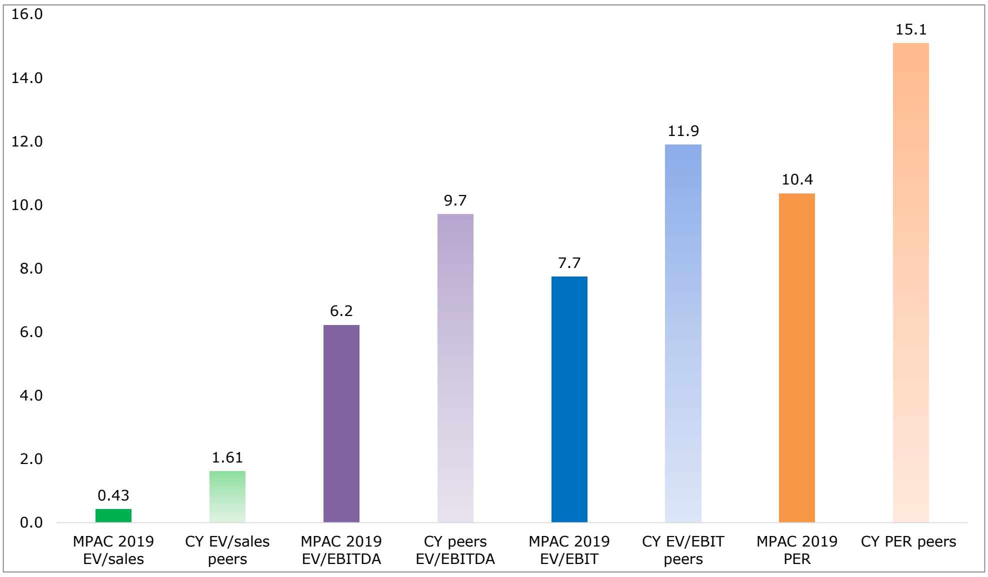
Upgraded our forecasts and valuation to 200p/share

There seems to be little danger too from commodity price pressures (eg steel & aluminium) and/or the Trump trade tariffs. Meaning that **we have raised our adjusted EBIT forecasts for this year** (+17.6%) **and next** (+16.0%) **to £3.5m and £4.4m** respectively - in turn **boosting the valuation from 170p to 200p/share**.

Plus, **if the Board's 'through-cycle' goal of double digit LFL revenue growth and consistent margin progression (target 10%) can be achieved**, then we could see the shares push considerably above 275p. Particularly given the unjustified discount the stock trades vs engineering/packaging peers (see below).

Stock trades at a material discount to peers

MPAC 2019 valuation benchmarks vs peers



Source: Equity Development

£27.0m cash pile ear-marked for organic growth

Nonetheless, more hard work & investment is required. Primarily developing/launching innovative new products (eg integrating remote diagnostics, data analytics and artificial intelligence), complemented perhaps by selective M&A. The latter maybe involving the purchase of **specialist knowhow, smart factory technology and/or solutions capability**, whilst being within the £5m-£25m price range and offering IRRs above 15%.

Hence, the Board's decision today not to recommend a dividend – and instead provisionally 'keep its powder dry' for internal and corporate development purposes. Moreover, in the event there was ever a 'hard/messy Brexit', the ensuing disruption could reset vendor expectations and provide the ideal backdrop to snap-up deep-value opportunities. Although equally, if no M&A candidates were found of the desired quality, calibre or at an acceptable price, then we think dividends would be reinstated in due course.

Conclusion of triennial valuation set for late 2019

With regards to the balance sheet, **net assets closed Dec'18 at £40.6m (or 201p/share)** with the UK defined pension surplus rising to £20.5m (vs £17.6m), mirroring robust investment returns, partly offset by a £7.3m charge related to the Lloyds Bank's High Court ruling in Oct'18 on the equalisation of guaranteed minimum pensions (GMP) for women & men.

Going forward, the main driver of UK recovery payments will be the outcome of the June 2018 triennial review (expected late 2019) – which employs more conservative actuarial assumptions and lower gilt yields. **Here, we suspect the deficit might have fallen from £70m in June 2015** (83% funded) **to below £50m** (see next page). Meaning that there should (in theory) be no reason for future contributions to rise.

Rough estimate of UK actuarial deficit

Triennial valuation (£'000s)	Jun'15	Est Jun'18
UK 10 year gilt yield	1.92%	1.37%
S&P UK BBB (Inv Grade) Corp Bonds	3.57%	3.01%
Spread Inv grade bonds vs gilts	1.65%	1.64%
UK RPI	1.01%	3.37%
Actuarial UK pension obligations	-419,300	-458,242
UK pension scheme assets	349,300	410,400
IFRS obligations	-356,900	-375,300
IFRS surplus/(deficit)	-7,600	35,100
Est actuarial funding level	**-83%**	**-90%**
Est actuarial deficit	**-70,000**	**-47,842**
Est RPI impact Jun'15-Jun'18		-9,099
Est gilt yield impact Jun'15-Jun'18		-3,843
Recovery payments pa	1,900	

Source: Equity Development

Prospects are "positive"

Finally, in terms of the 10 acres of spare land in Monks Risborough, Buckinghamshire (NBV £0.8m), we understand the company has not given up hope of eventually obtaining planning permission, albeit the latest configuration was recently rejected again by the local council.

CEO Tony Steels commenting, "*In the past year **we have continued to make sound progress with our strategic plans and have delivered top line growth, improved financial performance and an increased order book**.*

***The Group has both the financial and managerial resources available to develop the business, with the prime focus being on organic growth**. This will be delivered through the leveraging of its global position, development of its products and an improved services offering to its customers. We continue to evaluate potential complementary acquisition opportunities.*

*The Group entered 2019 with a stronger order book than the previous year and **2019 has started positively with order intake for the first two months ahead of the same period in 2018**.*

The Group aims to achieve double digit percentage revenue growth over the medium-term, culminating in delivering an improved Return on Sales, targeted at 10%." Underpinned by enhanced service revenues, product innovation, x/up-selling, economies of scale, offering 'end-to-end' solutions and the ongoing switch to 'smart manufacturing'.

Key risks

- As demonstrated in past recessions, capital equipment volumes are typically exposed to the cyclical nature of the global economy.
- The large size of the UK (£377.7m of liabilities) & US (£22.5m of liabilities) defined benefit pension schemes compared to MPAC's market capitalisation.
- Currency exposure, trade tariffs, raw material price increases (eg steel, aluminium) and competition.
- MPAC is smaller than its rivals/clients (eg German and Italian) and could see margins squeezed.
- Slower than expected growth, higher costs and/or lower cash generation.
- Industry suffers occasionally from lumpy orders, protracted customer purchasing decisions and irregular cashflows over the period end.
- Long term trend towards clients outsourcing production to 'low cost' contract manufacturers.
- Continued industry consolidation could impact pricing and margins.

Adjusted financial projections

MPAC plc - continuing (December year end)	2016 Act £'000s	2017 Act £'000s	2018 Act £'000s	2019 Est £'000s	2020 Est £'000s	2021 Est £'000s	2022 Est £'000s	2023 Est £'000s	2024 Est £'000s
Closing orderbook	**25,500**	**34,400**	**39,800**						
Growth		*35%*	*16%*						
Equipment	28,800	40,400	46,200	49,896	53,888	58,199	62,855	67,883	73,314
Service	12,700	13,000	12,100	13,068	14,113	15,243	16,462	17,779	19,201
Turnover	**41,500**	**53,400**	**58,300**	**62,964**	**68,001**	**73,441**	**79,317**	**85,662**	**92,515**
Equipment		*40.3%*	*14.4%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*
Service		*2.4%*	*-6.9%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*
Total % YoY growth		*28.7%*	*9.2%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*
Equipment	5,400	9,200	9,300	11,476	12,664	13,968	15,399	16,971	18,438
Service	5,600	5,300	4,700	5,227	5,645	6,097	6,585	7,112	7,680
Total gross margin	**11,000**	**14,500**	**14,000**	**16,703**	**18,309**	**20,065**	**21,984**	**24,082**	**26,119**
Equipment	*18.8%*	*22.8%*	*20.1%*	*23.0%*	*23.5%*	*24.0%*	*24.5%*	*25.0%*	*25.2%*
Service	*44.1%*	*40.8%*	*38.8%*	*40.0%*	*40.0%*	*40.0%*	*40.0%*	*40.0%*	*40.0%*
% Margin	*26.5%*	*27.2%*	*24.0%*	*26.5%*	*26.9%*	*27.3%*	*27.7%*	*28.1%*	*28.2%*
EBITDA	**450**	**2,200**	**2,200**	**4,327**	**5,328**	**6,449**	**7,701**	**9,099**	**10,400**
% Margin	*1.1%*	*4.1%*	*3.8%*	*6.9%*	*7.8%*	*8.8%*	*9.7%*	*10.6%*	*11.2%*
Distribution	-5,300	-5,400	-5,000	-5,320	-5,660	-6,023	-6,408	-6,818	-7,255
Administration	-6,600	-7,300	-7,200	-7,488	-7,788	-8,099	-8,423	-8,760	-9,110
Other	-300	-500	-400	-416	-433	-450	-468	-487	-506
Adjusted EBIT	**-1,200**	**1,300**	**1,400**	**3,479**	**4,428**	**5,493**	**6,685**	**8,017**	**9,248**
% Operating Margin	***-2.9%***	***2.4%***	***2.4%***	***5.5%***	***6.5%***	***7.5%***	***8.4%***	***9.4%***	***10.0%***
Underlying interest charge	-330	-170	0	0	0	0	0	0	0
Adjusted Profit before Tax	**-1,530**	**1,130**	**1,400**	**3,479**	**4,428**	**5,493**	**6,685**	**8,017**	**9,248**
Adjusted EPS (p)	**-6.0**	**4.2**	**4.5**	**13.0**	**16.5**	**20.4**	**24.7**	**29.8**	**34.4**
EPS growth rate			*7.8%*	*188.5%*	*26.6%*	*23.8%*	*21.1%*	*20.5%*	*15.3%*
Dividend (pence)	***1.25***	***0.00***	***0.00***	***0.00***	***0.00***	***0.00***	***0.00***	***0.00***	***0.00***
Reported sharecount (Ks - incl Treasury)	20,172	20,172	20,172	20,172	20,172	20,172	20,172	20,172	20,172
Valuation benchmarks									
P/E ratio		*32.3*	*29.9*	*10.4*	*8.2*	*6.6*	*5.5*	*4.5*	*3.9*
PER (adjusted for pension recovery payments)					*92.9*	*24.7*	*13.7*	*9.0*	*6.9*
EV/Sales (pension adjusted)	*0.65*	*0.50*	*0.46*	*0.43*	*0.40*	*0.37*	*0.34*	*0.31*	*0.29*
EV/EBITDA (pension adjusted)		*12.2*	*12.2*	*6.2*	*5.1*	*4.2*	*3.5*	*3.0*	*2.6*
EV/EBIT (pension adjusted)		*20.7*	*19.2*	*7.7*	*6.1*	*4.9*	*4.0*	*3.4*	*2.9*
PEG ratio			*3.81*	*0.05*	*0.31*	*0.28*	*0.26*	*0.22*	*0.26*
Corporate tex rate	*20.0%*	*26.5%*	*35.7%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*
EBITDA drop through rate			*0.0%*	*45.6%*	*19.9%*	*20.6%*	*21.3%*	*22.0%*	*19.0%*
Return on equity (%)		*1.9%*	*2.2%*	*6.0%*	*7.1%*	*8.1%*	*9.0%*	*9.7%*	*10.1%*
Net cash/(debt)	**800**	**29,400**	**27,000**	**24,940**	**23,624**	**23,138**	**23,578**	**25,052**	**27,481**
Information only - Estimated non-underlying Pension charges									
UK pension recovery payments			-1,900	-1,940	-1,981	-2,022	-2,065	-2,108	-2,152
UK pension admin costs			-900	-900	-900	-900	-900	-900	-900
UK tax shield			532	540	547	555	563	572	580
US pension recovery payments (net tax shield)			-790	-751	-701	-651	-601	-551	-501
Cashflow effect			**-3,058**	**-3,051**	**-3,034**	**-3,018**	**-3,002**	**-2,987**	**-2,973**
Net cash/(debt) - pence per share		**146**	**134**	**124**	**117**	**115**	**117**	**124**	**136**
Net assets / diluted share (p)	175	212	201	214	231	251	276	306	340
Shareprice (p)	**135**								

Source: Equity Development. MPAC's EV has been adjusted for pension. The cost of UK PPF levy is included within EBIT.

Investor Access

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